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No. 546

In the

SUPREME COURT OF THE UNITED STATES

October Term, 1966

EDGAR I. SHOTT, JR.,
Petitioner

vs.

THOMAS A. CONROY, Trustee in Bankruptcy for Leslie D. Stickler, Bankrupt,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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THOMAS A. CONROY, Trustee in Bankruptcy for Leslie D. Stickler, Bankrupt,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit, entered in the above entitled case on July 8, 1966.

OPINION BELOW

The decision and opinion of the United States Court of Appeals for the Sixth Circuit is reported in —— F. (2d) ——.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on July 8, 1966 and the order of such court denying petition for rehearing was entered on Au-

gust 9, 1966. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254 (1).

QUESTION PRESENTED

Whether Respondent's motion for summary judgment was properly granted in an action to recover payments of money made by the Bankrupt to Petitioner where (i) the court was required to resolve contested issues of material facts as to the fraudulent intent of the Bankrupt and as to Petitioner's knowledge thereof, and where (ii) the court erred in its application of the substantive law of the State of Ohio?

THE STATUTES INVOLVED

In addition to Rule 56, Federal Rules of Civil Procedure, reproduced in the Appendix, the following statutes are pertinent:

"Title 11 U.S.C. Sec. 110e (1) and (3)

Title to Property

e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

* * *

(3) For the purpose of such recovery or of the avoidance of such transfer or obligation, where plenary proceedings are necessary, any State Court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction.

Ohio Revised Code

Sec. 1313.56 Appointment of receiver. (G.C. Sec. 11104)

> A sale, conveyance, transfer, mortgage, or assignment, made in trust or otherwise by a debtor, and every judgment suffered by him against himself in contemplation of insolvency and with a design to prefer one or more creditors to the exclusion in whole or in part of others, and a sale, conveyance, transfer, mortgage, or assignment made, or judgment procured by him to be rendered, in any manner, with intent to hinder, delay, or defraud creditors, is void as to creditors of such debtor at the suit of any creditor.
>
> * * *

Sec. 1313.57 Knowledge of fraudulent intent material; mortgage in good faith (G.C. Sec. 11105)

> Section 1313.56 of the Revised Code does not apply unless the person to whom such sale, conveyance, transfer, mortgage, or assignment is made, knew of such fraudulent intent on the part of such debtor. . . ."

While Respondent also relied on Ohio Revised Code Section 1335.02, entitled "Gifts and grants to defraud creditors void," the opinion of the Court of Appeals discloses sole reliance on the two Ohio statutes quoted above.

STATEMENT OF THE CASE

The essential facts may be extracted from the opinion below:

> ". . . the district court . . . granted the motion of plaintiff-appellee (Respondent) for summary judgment, overruled the motion of defendant-appellant (Petitioner) for summary judgment, and entered judgment against defendant-appellant (Petitioner) for $1,363,410.00 with interest and costs.

> Plaintiff-appellee (Respondent), Thomas A. Conroy, is the trustee in bankruptcy for Leslie D. Stickler, referred to herein as 'bankrupt.' The bankrupt inaugurated a scheme wherein he would borrow a sum of money from A, then borrow from B to repay A, borrow from C to repay B and so on. The inducement was a high rate of interest on a short term. This is referred to as a 'Ponzi'-type scheme. See *Cunningham, Trustee of Ponzi* v. *Brown*, 265 U.S. 1.
>
> (Petitioner), Edgar I Shott, Jr. . . . was a lender to the bankrupt. Both bankrupt and (Petitioner) were attorneys and had been friends since childhood. Millions of dollars were involved in the scheme and it appears that some 120 or more people made loans to the bankrupt in widely varying amounts, aggregating $3,309,462.05.
>
> The trustee sued the (petitioner) to recover a cumulative total of $1,343,410.00, representing some 600 transactions between the (petitioner) and the bankrupt. The action was filed on March 20, 1963, more than two years after the January 18, 1961 adjudication of bankruptcy.[1] The action is maintained under authority of 11 U.S.C. Sec. 110 (e) (1), (Section 70 (e) (1) of the Federal Bankruptcy Act.)'"[2]

The Court of Appeals, in an opinion marked by the almost total lack of independent intellectual endeavor,

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[1] Petitioner's contention that the two-year statute of limitations of 11 U.S.C. Sec. 29(e) barred all claims except those maintainable under the provisions of 11 U.S.C. Sec. 110e(1) was upheld by the district court.

[2] Because diversity of citizenship is lacking, the action was maintainable in the district court only because of the language of 11 U.S.C. Sec. 110e(3), which provides:

> "F. . the purpose of such recovery or of the avoidance of such transfer or obligation, where plenary proceedings are necessary, any State Court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

quotes almost the entire written opinion of the District Judge and then concludes:

> "*Upon the basis of the above quoted language* from the opinion of the district court, we conclude that defendant is charged with constructive knowledge of the fraudulent intent of the bankrupt under facts which are not disputed and that the district judge was correct in granting plaintiff's motion for summary judgment on the legal issue of liability." (Emphasis added)

Having affirmed the grant of summary judgment on the liability issue, the judgment of the District Court was vacated and the case ordered remanded solely for a redetermination of the amount of the judgment. On August 19, 1966 an order was entered by the Court of Appeals staying the issuance of mandate in this case for thirty (30) days in order to permit the filing of this petition.

RESPONDENT'S MOTION FOR SUMMARY JUDGMENT

Although the parties herein had, by joint request, obtained an order that the issues in this case be tried by a jury (App. 7a),[3] the District Judge later suggested the utilization of motions for summary judgment in an attempt to resolve the issue of liability prior to submission of evidence on the issue of damages. While Respondent advanced various legal theories in support of his motion, the District Court grant of the motion was grounded solely on Ohio Revised Code Sec. 1313.56 which provides for voidability of a transfer where there has been an intent to establish preferences among or to defraud credi-

[3] Appellant's Appendix as certificated to this Court as part of the record below. Nine additional copies have been lodged with the Clerk.

tors and on Ohio Revised Code Sec. 1313.57 which limits the application of the preceding section to situations where the transferee "knew of such fraudulent intent on the part of such debtor." It was, therefore, the conclusion of the District Judge that every time the bankrupt made payments to Petitioner, in some "600 or more transactions" spanning a period of five years, the bankrupt had a fraudulent intent to prefer Petitioner or a fraudulent intent to defraud other creditors and that Petitioner knew of such fraudulent intent. Such conclusion was affirmed by the Court of Appeals.

The supporting papers of Respondent consisted of three affidavits — one by Respondent trustee (App. 17a) and two by a Certified Public Accountant (App. 18a) employed by Respondent. Respondent's affidavit described in general and brief terms, the operation of the bankrupt's "get rich quick" scheme. The two affidavits of the accountant contain his opinions and conclusions based upon his "construction" and "reconstruction" of the bankrupt's "books, records and schedules." The first affidavit of the accountant states:

> "The facts disclose further that during the operation of his enterprise Stickler intermingled all of his funds, i.e., those received in the enterprise as well as those *in his law business* and *other personal sources of income* and deposited substantially all of said funds in the same bank account." (Emphasis added). (App. 19a)

Such affidavit also contained the assertion that "Stickler paid Shott in some instances by endorsing checks to Shott received by Stickler from other lenders who were also participating in Stickler's enterprise."

Petitioner's supporting papers consisted of his affidavit (App. 26a) and that of his secretary (App. 28a). Petitioner

denied that he had knowledge or reason to believe that payments made to him on his loans were made with funds borrowed from others; established that his debts were never prepaid by the bankrupt; denied knowledge of, or reason to believe, insolvency of the bankrupt until the matter became public in January 1961, and stated.

> "5. I did not, nor do I now believe, that in paying the promissory notes which represented the loans I had made to Stickler, that Stickler intended to prefer me over any other creditor or intended to hinder, delay or defraud any other creditor." (App. 27a)

Petitioner's secretary's affidavit concluded:

> "6. I was in daily contact with Mr. Shott at the office five or six hours a day for five and one-half days a week for the six-month period preceding January 7, 1961, and I know that Mr. Shott had no knowledge of the actual state of Mr. Stickler's financial affairs. During this entire period Mr. Shott was convinced that Mr. Stickler was a highly successful attorney and a man of integrity. At no time prior to January 7, 1961 did Mr. Shott believe or have reason to believe that Mr. Stickler had any fraudulent intent." (App. 29a)

During the Pre-Trial conference, the District Court sought enlightenment on the question of the bankrupt's intent and asked:

> "Has it ever developed in any of these various proceedings as to what Stickler did have in his mind in this thing? Where did he think he was going with this scheme? Did anybody ever make any sense out of that?" (App. 16b)

Respondent's counsel replied:

> "MR. SPIEGEL: He was asked the question on one of the 21-A exams. We were trying to establish at

that time his insolvency throughout; and he claimed that he thought he had a successful law practice and that he was going to be able to meet all those obligations, that he didn't think it would be able to develop into the crescendo that it did in 1960. I don't know if the man was sick or what the situation was, or what he had in mind, and it's sort of hard to conjecture." (App. 16b)

Respondent stated:

"MR. CONROY: He couldn't really explain what he had in mind near the end, but at the beginning he thought he would work out when it started." (App. 17b)

On the question of the bankrupt's fraudulent intent, counsel for Respondent concluded:

"The question of Mr. Stickler's intent, with all due respect to Mr. Andrews, is an arguable point." (App. 41b)

Respondent did not offer any evidence by the bankrupt, either in affidavit form or by transcript of his testimony given in the bankruptcy proceedings.

THE DISTRICT COURT'S DECISION ON THE MOTION

The District Court held that the "Ponzi"-type operation conducted by the bankrupt, itself being steeped in fraud, is the legal equivalent of an intent by the bankrupt to establish preferences among or to defraud creditors, which is what the Ohio statute condemns. The court said:

"However, since he was insolvent from the moment of the making of the first loan, and since there has

never been a suggestion that any source of income existed except new loans,[4] (if such may be considered a 'source of income'), the question of intent to defraud is not debatable." (App. 33a)

On the question of Petitioner's knowledge of the fraudulent intent to prefer or defraud creditors, the District Court found that there was a "deficiency in the evidence" as to actual knowledge but that such deficiency "does not exist as to constructive knowledge, however, and the record fully supports the conclusion that defendant should have had knowledge of Stickler's fraudulent scheme." (App. 34a). The court's conclusion as to what Petitioner "should have known" was based on "evidence" of "over 600 transactions" from "1956 and extended into 1961" "with exorbitant 'profits' to the lender" to whom "the proper test becomes what a reasonably prudent attorney with a special knowledge of investment matters knew or should have known concerning the financial structure and operation of an individual to whom in hundreds of transactions he advanced sums in excess of $1,000,000." (App. 33a-34a).

The District Court's written opinion contains no reference whatever to Petitioner's supporting affidavits. The opinion of the Court of Appeals would indicate that no examination was made by it of Petitioner's affidavits in that its conclusion "that defendant is charged with constructive knowledge of the fraudulent intent of the bankrupt" was admittedly reached solely on "the basis of the above quoted language from the opinion of the District Court."

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[4] Respondent's supporting papers referred to the bankrupt's income from his "law business and other personal sources of income." (App. 19a).

REASONS FOR ALLOWING THE WRIT

The decision below is in substantial conflict with the applicable decisions of this Court on the role of summary judgment under Rule 56, F.R.C.P. It stands as a unique departure from the well enunciated and well understood decisions thoughout the Federal judiciary in this area. Like the unfortunate illegitimate child brought to the family reunion, it will command no love, nor respect, but, unless reversed, will be used as an "example" for the entire family. It will become an "authority" by which the efficacious use of summary judgment procedure is so seriously impaired that this Court will be besieged by litigants seeking the return to a legally oriented philosophy.

Two core factual questions were before the lower court:

1. Did the bankrupt have an intent to prefer Petitioner over his other creditors or an intent to defraud his other creditors when he repaid Petitioner's loans, at maturity, over a period of five years?
2. If the bankrupt had such a fraudulent intent, did Petitioner know it?

The resolution of these questions requires a determination of the subjective mental processes of two human beings. That summary judgment, is contra-indicated in such area has already been established by this Court.

> "Summary judgments have a place in the anti-trust field, as elsewhere, though, as we warned in *Poller* v. *Columbia Broadcasting System,* 368 U.S. 464, 473, they are not appropriate 'where motive and intent play leading roles.' "
>
> *White Motor Co.* v. *United States,* 372 U.S. 253, 259 (1963)

The District Court ignored the fact that the bankrupt continued to repay all his creditors until he was suddenly forced to suspend operations by the Ohio Division of Securities. It was undoubtedly this fact which prompted the candid admissions of Respondent and his counsel quoted earlier. The bankrupt, himself, had testified in such a manner as to negative a fraudulent intent, but this testimony was not offered by Respondent. It is conceivable that he believed that the proceeds from his "law business and other personal sources of income" would extricate him or, in the alternative, that his operation would continue to expand to the extent that all of his present creditors would be replaced by a new set of creditors. The test, under 11 U.S.C. Sec. 110e (1), is whether he intended to defraud "any creditor of the debtor, having a claim provable under this Act. . . ." Whether he intended to defraud and, if so, who, are subjective questions to be answered by a jury after a full presentation of all the evidence. The District Court's conclusion, as approved by the court below, that "the question of intent to defraud is not debatable" because "there has never been a suggestion that any source of income existed except new loans" is directly contradicted by Respondent's own evidence as to proceeds from the bankrupt's "law business and other personal sources of income" and dramatizes the absurd utilization of summary judgment in the instant case.

The paramount error, most likely to produce judicial mischief, lies in the approval by the court below of the District Court's consideration of the question of Petitioner's knowledge of the bankrupt's frame of mind. By the express terms of Ohio Revised Code Sec. 1313.57, any proscribed intent on the part of the bankrupt would be of utterly no consequence unless and until it is established that Petitioner "knew of such fraudulent intent on the

part of such debtor." The District Court concluded that "the record fully supports the conclusion that defendant should have had knowledge[5] of Stickler's fraudulent scheme."[6] The "record" consists of five affidavits. Respondent's three affidavits are silent on the question of Petitioner's knowledge. Petitioner's affidavit contained his sworn statement:

> "I did not, nor do I now believe, . . . that Stickler intended to prefer me over any other creditor or intended to hinder, delay or defraud any other creditor."

Petitioner's secretary, by affidavit, confirmed his claim. While neither of the opinions below make even passing reference to Petitioner's supporting papers, it is clear that the District Judge decided that the weight of the evidence preponderated in favor of Respondent. The court framed three issues on the question of Petitioner's knowledge and stated that ". . . evidence is found which would support an affirmative answer to either of the first two." (App. 33a) and "It is further concluded that the third issue should also be resolved affirmatively to the plaintiff." (App. 35a) But the trial court is not authorized to weigh evidence or resolve disputed evidential facts on a motion for summary judgment. This Court, in an opinion by Mr. Justice Black affirming the grant of summary judgment, stated:

> "The court below in making findings and entering judgment carefully abstained from the consideration of any evidence which might possibly be in dispute.

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[5] The substantive law of Ohio requires actual knowledge as demonstrated *infra*.

[6] Knowledge of the fraudulent "scheme" is of no significance. The interdiction of the statutes apply only to transfers where the transferee knew of a fraudulent intent to prefer or defraud creditors.

> We agree that Rule 56 should be cautiously invoked to the end that parties may always be afforded a trial where there is a bona fide dispute of facts between them."
>
> *Associated Press* v. *United States*, 326 U.S. 1, 6 (1945)

More recently Mr. Chief Justice Warren, in an opinion reversing summary judgment, wrote:

> "Other allegations which in some circumstances might have a bearing on the subject were controverted and therefore can only be resolved by a trial on the merits."
>
> *Free* v. *Bland*, 369 U.S. 663, 671 (1962)

While Respondent's supporting papers were not remotely addressed to the two core questions before the District Court, Petitioner's papers vigorously denied not only his knowledge of the bankrupt's fraudulent intent, but the very existence of the proscribed intent. It would appear that the District Court failed to profit from its previous experience in having its improvident grant of summary judgment reversed by this Court. On that occasion (*United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962)), this Court said:

> "The latter finding represents at least in part the resolution of a head on factual controversy as revealed by the materials before the District Court. . . . In any event both findings represent a choice of inferences to be drawn from the subsidiary facts contained in the affidavits, attached exhibits, and depositions submitted below. On summary judgment the inferences to be drawn from the underlying facts contained in such materials must be viewed in the light most favorable to the party opposing the motion."

There was no occasion here for the District Court to concern itself with subtle nuances or underlying facts. To the

extent that there may be said to have been a "head on factual controversy," it did not involve the necessity of repelling, or controverting, anything offered by Respondent. Petitioner's affidavits, in fact, were in no way questioned nor controverted!

As demonstrated, the decision below represents a fundamental and irreconcilable conflict with the applicable decisions of this Court on the same subject.

> ". . . Rule 56 authorizes summary judgment only when the moving party is entitled to judgment as a matter of law, where it is quite clear what the truth is, that no genuine issue remains for trial . . . ."
>
> *Sartor* v. *Arkansas Gas Corp.*, 321 U.S. 620, 627 (1944)

Such decision, which we earlier characterized as an "illegitimate child", is in reality a "bastard" among the well-reasoned opinions with which the official reports abound. For brief example:

> "All doubts as to the existence of a genuine issue as to a material fact must be resolved against the party moving for summary judgment."
>
> *Sarnoff* v. *Ciaglia*, 165 F.2d. 167, (C.A. 3, 1947); *Weisser* v. *Mursam Shoe Corporation*, 127 F.2d. 344 (C.A. 2, 1942); 6 *Moores Federal Practice* 2nd Ed. Sec. 56.11, p. 2070.

> "On motion for summary judgment it is no part of the court's function to try issues of fact, but solely to determine whether there is an issue of fact to be tried."
>
> *Empire Electronics Co.* v. *United States*, 311 F.2d. 175 (C.A. 2, 1962); *Bohn Aluminum & Brass Corp.* v. *Storm King Corp.*, 303 F.2d. 425 (C.A. 6, 1962); *Stanley* v. *Alcock*, 310 F.2d. 17 (C.A. 5, 1962); *Toebelman* v. *Missouri-Kansas Pipe Line Co.*, 130 F.2d.

1016, (C.A. 3, 1942); 6 *Moores Federal Practice* 2d. Ed. Sec. 56.15, p. 2101; 3 *Barron & Holtzoff Federal Practice and Procedure*, Sec. 1231, p. 101.

While we recognize that the denial of certiorari has no official precedential effect, it is submitted that the failure to specifically reject the opinion below — particularly since it merely consists of a verbatim recitation of the opinion of the District Court — would cause incalculable damage and confusion in the summary judgment field. The instant case, for instance, is only the first to be resolved by the District Court in a long series of cases filed by Respondent against numerous defendants based on the same factual situation. This Court should not countenance the injustice which would be visited upon numerous individuals upon its failure to reverse a decision which stands alone in opposition to the clear pronouncements of this Court.

(ii)

The judgment of the District Court was based upon its evidential determination that Petitioner "should have had knowledge" (App. 34a) of the bankrupt's "fraudulent scheme." The Ohio statute (R.C. Sec. 1313.57) explicitly validates fraudulent transfers except those where the transferee "knew of such fraudulent intent on the part of such debtor. . . ." The Ohio Supreme Court has accepted the literal wording of the statute and has determined that "actual" knowledge by the transferee is required in order to vitiate a fraudulent transfer. *Lytle* v. *Baldinger*, 84 O.S. 1 (1911); *Carruthers* v. *Kennedy*, 121 O.S. 8 (1929). The cases cited by counsel for Respondent in the lower court on this point involve either actual knowl-

edge or such facts as in law charged the transferee with actual knowledge. The determination by the District Court as to the substantive law of Ohio, as approved by the court below, is in direct conflict with the applicable decisions of the highest court of Ohio.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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